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The Ongoing Impact Of Del. Courts On US M&A

Law360, New York (February 07, 2013, 12:04 PM ET) -- The past year of M&A litigation in Delaware resulted in several decisions with important implications for parties engaging in or advising on M&A transactions.

Controlling Stockholder Transactions

The 2012 Delaware Supreme Court opinion in Americas Mining Corporation v. Theriault provides dramatic evidence of the risks inherent in transactions in which a controlling stockholder stands on both sides of a transaction, thus implicating the entire fairness standard of review. In Americas Mining, the Supreme Court affirmed post-trial findings that "a focused, aggressive controller" extracted a deal that was "far better than market," resulting in "a manifestly unfair transaction." The court let stand a damages award of more than $2 billion against a controlling stockholder and its affiliate directors for breach of fiduciary duty, as well as an attorneys' fees and expenses award of more than $300 million.

Transactions involving companies with a controlling stockholder offer fertile ground for litigation, even where the controlling stockholder does not stand on both sides. In In re Delphi Financial Group Shareholder Litigation, the Court of Chancery declined to enjoin the stockholder vote on the Delphi/Tokio Marine Holdings merger, even though it concluded that a controlling stockholder likely breached his fiduciary duties by successfully demanding a premium for his high-vote shares.

While confirming that a controlling stockholder generally is permitted to negotiate a control premium for its shares, the court found that, in this case, the controlling stockholder had already "sold his right to a control premium," via a provision in the company's certificate of incorporation that required equal consideration to be paid to the high-vote and low-vote shares in a merger. As a result, the court found the controlling stockholder's attempt to "extract a second control premium for himself" at the expense of the minority stockholders likely to be a breach of fiduciary duty.

The court, however, refused to enjoin the stockholder vote on the merger and permitted stockholders to decide for themselves whether to accept the 76 percent premium offered in the merger. The court noted the absence of evidence "that another suitor is in the wings or is likely to be developed at a greater, or even equal, price." In so holding, the court noted the similarities present in its prior decision in In re El Paso Corporation Shareholder Litigation.

In that case, the court identified numerous "debatable negotiating and tactical choices made by El Paso fiduciaries and advisors," which were compounded by a lead negotiator and financial adviser with interests in conflict with those of the El Paso stockholders. Nevertheless, the court declined to issue an injunction and permitted the El Paso stockholders to vote on the merger in light of the 37 percent premium it offered and the absence of other bids. In refusing to enjoin the Delphi/Tokio Marine Holdings merger, the court noted that the 76 percent premium offered in the merger "dwarfs the premium percentage in El Paso." The claims asserted in the Delphi litigation were ultimately settled for approximately $50 million.

In contrast to the Delphi decision, in a case involving a merger between Synthes Inc. and Johnson & Johnson, the Court of Chancery found that stockholder plaintiffs had not stated a breach of fiduciary duty claim against a controlling stockholder. In dismissing the stockholder plaintiffs' claims in In re Synthes Inc. Shareholder Litigation, the court explained that "although the controller was allowed by our law to seek a premium for his own controlling position, he did not and instead allowed the minority to share ratably in the control premium paid by J & J." The court found that, as alleged, the controlling stockholder did not have:

> any conflict with the minority that justifies the imposition of the entire fairness standard. The controlling stockholder had more incentive than anyone to maximize the sale price of the company, and Delaware does not require a controlling stockholder to penalize itself and accept less than the minority, in order to afford the minority better terms. Rather, pro rata treatment remains a form of safe harbor under our law.

In another case, the Court of Chancery confirmed additional procedures by which certain transactions involving a controlling stockholder may avoid entire fairness review entirely. In Frank v. Elgamal, the court stated that when a corporation with a controlling stockholder merges with an unaffiliated company, minority stockholders are cashed out, and the controller receives a minority stake in the surviving entity, entire fairness will not apply if the transaction includes "robust procedural protections."

The court explained that these protections include the recommendation of the transaction by an independent and disinterested special committee and the approval of the transaction by the nonwaivable vote of a majority of the minority stockholders. When such procedural protections are included in these types of transactions, business judgment, rather than entire fairness, is the applicable standard of review.

Increase in Deal Litigation and Other Observations

The frequency of stockholder lawsuits challenging M&A transactions accelerated in 2012. The Court of Chancery has noted this trend. For example, in March, Vice Chancellor J. Travis Laster noted in Stourbridge Investments LLC v. Bersoff that:

> the past decade has witnessed a dramatic transformation in the nature of public company M&A litigation. In 2010, 84.2 percent of announced deals attracted lawsuits. In 2010 and 2011, according to Cornerstone Research, 91 percent attracted lawsuits. According to the data for 2011, in the same study, 96 percent of deals valued at $500 million or more attracted lawsuits. That's compared to 53 percent in 2007. As these volumes have increased, merits-related outcomes have decreased.

In addition to increasingly frequent M&A litigation in the Delaware courts, the plaintiffs' bar continues to file M&A-related litigation outside of Delaware, even when challenging transactions involving companies domiciled in Delaware. We see no indication this trend will reverse in 2013.

Finally, as noted above, a number of 2012 decisions confirm Delaware's continued commitment to informed stockholder franchise. So long as disclosures are materially complete and accurate, the Delaware courts appear reluctant to take from stockholders the opportunity to decide for themselves whether or not to accept a premium transaction.

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